

Vault Global Opportunities, L.P. v J.D. Clark & Co.

2012 NY Slip Op 33390(U)

March 8, 2012

Sup Ct, New York County

Docket Number: 650616/2011

Judge: Shirley Werner Kornreich

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SUPREME COURT OF THE STATE OF NEW YORK NEW YORK COUNTY

PRESENT: JUSTICE SHIRLEY WERNER KORNREICH
Justice

PART 54

Index Number : 650616/2011
VAULT GLOBAL OPPORTUNITIES,
VS.
J.D. CLARK & CO.
SEQUENCE NUMBER : 001
DISMISS

INDEX NO. _____
MOTION DATE _____
MOTION SEQ. NO. _____

The following papers, numbered 1 to _____, were read on this motion to/for _____

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ | No(s) 17, 18
Answering Affidavits — Exhibits _____ | No(s) 32, 33, 34
Replying Affidavits _____ | No(s) 36

Upon the foregoing papers, it is ordered that this motion is decided in accordance
with the annexed decision.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE
FOR THE FOLLOWING REASON(S):

Dated: 3/8/12

JUSTICE SHIRLEY WERNER KORNREICH
[Signature], J.S.C.

- 1. CHECK ONE: CASE DISPOSED NON-FINAL DISPOSITION
- 2. CHECK AS APPROPRIATE: MOTION IS: GRANTED DENIED GRANTED IN PART OTHER
- 3. CHECK IF APPROPRIATE: SETTLE ORDER SUBMIT ORDER
- DO NOT POST FIDUCIARY APPOINTMENT REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

-----X
VAULT GLOBAL OPPORTUNITIES, L.P.,
VAULT GLOBAL OPPORTUNITIES MASTER
FUND, LTD., VAULT GLOBAL OPPORTUNITIES
OFFSHORE, LTD.,

Plaintiffs,

-against-

Index No. 650616/11
Decision & Order

J.D. CLARK & CO. and ROTHSTEIN KASS
& CO.,

Defendants.

-----X
SHIRLEY WERNER KORNREICH, J.:

In this action alleging accounting malpractice, defendant Rothstein Kass & Co. (Rothstein) moves, pursuant to CPLR 3211 (a) (7), for an order dismissing the complaint as against it.

I. Background

Plaintiffs Vault Global Opportunities, L.P., Vault Global Opportunities Master Fund, LTD., and Vault Global Opportunities Offshore, LTD. are hedge funds, engaging in complex investment transactions. According to the complaint, plaintiffs contracted with defendant J.D. Clark & Co. (J.D. Clark) for J.D. Clark to act as plaintiffs' third-party administrator. Under the agreement, J.D. Clark "undertook responsibility for administrative services ... including 'such general administrative and accounting services as are customarily provided by administrators'" of hedge funds. Aff. of Mark A. Harmon, Ex. A, Complaint, ¶ 15.

Plaintiffs' prime broker was nonparty U.B.S. Securities, L.L.C. (UBS). According to the complaint, UBS was required to produce "Prime Broker Statements", and J.D. Clark was to

“accurately calculate [plaintiffs’] net asset value (NAV)” (*id.*) by reconciling plaintiffs’ books with the Prime Broker Statements. *Id.*, ¶ 24.

Rothstein was hired by plaintiffs, pursuant to letter agreements (Complaint, Ex. 2)(engagement letters). In the engagement letters, Rothstein agreed to perform an audit of plaintiffs’ 2007 financial statements “in accordance with GAAS [Generally Accepted Auditing Standards] and to provide an opinion about whether the financial statements were fairly presented in conformance with Generally Accepted Accounting Principles (‘GAAP’) and free of any material misrepresentations.” Complaint, ¶ 22.

Plaintiffs claim that J.D. Clark breached its agreement with plaintiffs by failing to reconcile plaintiffs’ records with the Prime Broker Statements, essentially rubber-stamping UBS’s statements as plaintiffs’ own. As a result, J.D. Clark allegedly failed to calculate plaintiffs’ NAV correctly, which allowed redeeming investors to be overpaid, causing a loss to plaintiff of millions of dollars. Plaintiffs further allege that Rothstein breached the engagement letters by failing to detect J.D. Clark’s negligence and, as a result, validated an audit that did not reflect the reality of plaintiffs’ actual financial state.

The crux of Rothstein’s motion is its claim that it had no obligation to review J.D. Clark’s calculations and, thus, was not required to discover the incorrectly calculated NAV. Rothstein argues that plaintiffs have failed to specifically allege what GAAS standards it has failed to maintain and what contractual obligations it has failed to meet. Rothstein also contends that plaintiffs have failed to allege proximate cause, in that plaintiffs cannot, allegedly, point to any connection between the 2007 audit and the damages ensuing from the incorrect NAV.

II. Discussion

On a motion to dismiss pursuant to CPLR 3211, we must accept as true the facts as alleged in the complaint and submissions in opposition to the motion, accord plaintiffs the benefit of every possible favorable inference and determine only whether the facts as alleged fit within any cognizable legal theory.

Sokoloff v Harriman Estates Development Corp., 96 NY2d 409, 414 (2001); *see also Leon v Martinez*, 84 NY2d 83 (1994). “Whether a plaintiff can ultimately establish its allegations is not part of the calculus in determining a motion to dismiss.” *Ginsburg Development Companies, LLC v Carbone*, 85 AD3d 1110, 1111 (2d Dept 2011), quoting *EBC I, Inc. v Goldman, Sachs & Co.*, 5 NY3d 11, 19 (2005).

A claim alleging accounting malpractice “requires proof that there was a departure from accepted standards of practice and that the departure was a proximate cause of the injury.” *D.D. Hamilton Textiles, Inc. v Estate of Mate*, 269 AD2d 214, 215 (1st Dept 2000); *see also Kristina Denise Enterprises, Inc. v Arnold*, 41 AD3d 788 (2d Dept 2007). Rothstein argues that plaintiffs have failed completely to identify with particularity any standards of GAAS which Rothstein failed to meet. Specifically, Rothstein maintains that there is no allegation that it had any duty to investigate J.D. Clark’s handling of plaintiffs’ “internal controls,” and, as such, no duty to detect J.D. Clark’s mistakes.

While Rothstein points to sections of the engagement letters in which it appears that Rothstein is specifically freed of any obligation to review J.D. Clark’s internal controls (*see* Complaint, Ex. 2, at 2, “[a]n audit is not designed to provide assurances on internal control or to identify deficiencies in internal control”; “Management is responsible for establishing and maintaining internal controls, including monitoring ongoing activities” [*id.*]), other sections of the engagement letters appear to include a duty to investigate on Rothstein’s part. *See* Complaint, Ex. 2, at 2 (“[o]ur audit will include obtaining an understanding of the Fund and its

environment, including internal control, sufficient to assess the risks of material misstatements of the financial statements and to design the nature, timing and extent of further audit procedures”). Since the engagement letters are ambiguous as to the scope of Rothstein’s duties vis-à-vis its obligations to investigate deeper into J.D. Clark’s oversight of plaintiffs’ financial affairs, the allegations of misconduct in this regard are, at this time, sufficient to defeat a motion to dismiss.

Plaintiffs’ complaint also specifies an instance in which Rothstein, during the audit, discovered a \$2.7 million “cash discrepancy” (Complaint, ¶ 29), which J.D. Clark was unable to explain. J.D. Clark allegedly turned to UBS to explain the discrepancy, and was told it was “away cash,” that is, cash being held by UBS and other brokers from swap transactions. *Id.* at 32. It is plaintiffs’ position that this discrepancy was never adequately explained, and that J.D. Clark’s inability to explain the discrepancy showed gaping flaws in its internal controls, which should have been evident to Rothstein, and should have made Rothstein suspicious of J.D. Clark’s financial information in general. Again, these allegations are specific enough to support an inference that Rothstein might have had an obligation under GAAS to make inquiries, in the course of its audit, which it failed to do. Therefore, this court finds that plaintiffs have sufficiently alleged, at the pleading stage, that Rothstein failed in its duty to conduct the audit in accordance with GAAS.

Having determined that plaintiffs have alleged departures from professional standards on Rothstein’s part, they must now allege proximate cause. This is more problematic.

Plaintiffs’ damages arose because its NAV was overestimated, causing it to pay out to its redeeming investors more than was their share. Plaintiffs must connect Rothstein’s alleged failures in ensuring a correct audit with the miscalculation of the NAV.

J.D. Clark's malpractice is defined as its failure to "generate correct financial reporting packages, correctly calculate the NAV, and correctly calculate appropriate allocations and partner account statements." Complaint, ¶ 47. Rothstein's malpractice, with regard to the NAV, is that Rothsein "failed to determine that [plaintiffs'] financial statement contained material misstatements" (*id.*, ¶ 57), and "[a]s a direct consequence of [Rothstein's] negligent departure from GAAS ... [plaintiffs] were not aware that the NAV was calculated incorrectly which resulted in overpayment to redeeming investors." *Id.*, ¶ 58.

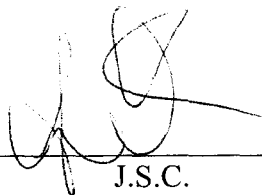
At this juncture, plaintiffs have pleaded sufficient causation to withstand a motion to dismiss. The extent of Rothstein's obligations to plaintiffs with regard to the calculation of the NAV has yet to be explored, and further inquiry will clarify whether a failure in this regard caused plaintiffs' injuries. Accordingly, it is

ORDERED that the motion brought by defendant Rothstein Kass & Co. to dismiss the complaint is denied; and it is further

ORDERED that said defendant is directed to serve an answer to the complaint within 10 days of receipt of a copy of this order with notice of entry.

Dated: March 8, 2012

ENTER:



J.S.C.